

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

AN ADJUSTMENT OF RATES OF HARRISON       )  
COUNTY WATER ASSOCIATION, INC.       )   CASE NO. 8911

O R D E R

On October 3, 1983, Harrison County Water Association, Inc., ("Harrison County") filed an application with this Commission requesting authority to increase its rates pursuant to 807 KAR 5:001. Harrison County stated that the proposed rates would produce total annual revenue in the amount of \$346,353, reflecting an increase of \$78,697, or 29 percent above test-period revenue.

An examination of Harrison County's test-period revenue, as well as the billing analysis submitted in the application, revealed that Harrison County was not reporting the total amount of revenue associated with the sales of water at its truck-loading stations. To reflect the revenue associated with these water sales, Harrison County's test-period revenue has been increased by an amount of \$4,645, resulting in total normalized revenue of \$272,301, based on the number of gallons of water sold per Harrison County's test-period billing analysis.<sup>1</sup> In addition,

<sup>1</sup>	Total water sales per billing analysis	\$267,656
	Adjustment for truck-loading sales:	
	9,290,490 gallons at \$.50 per 1,000 gallons	4,645
	Normalized revenue	<u>\$272,301</u>

Harrison County's proposed rates, as presented per the billing analysis, did not reflect the additional revenue in the amount of \$6,039 that would be produced from water sales at the truck-loading stations. Therefore, the rates requested by Harrison County would actually produce total annual revenue in the amount of \$352,392, reflecting an increase of \$80,091, or 29 percent above test-period normalized revenue. Based upon the determination herein, Harrison County will be allowed to increase its rates to produce total annual revenues in the amount of \$352,392, thus reflecting the proposed \$80,091 revenue increase.

On February 8, 1984, a hearing was held in this matter at the Commission's offices in Frankfort, Kentucky. All information requested by the Commission in association with this case has been filed.

#### COMMENTARY

Harrison County is a non-profit water association, organized and existing under the laws of the Commonwealth of Kentucky, and serves approximately 1,320 residential and 103 commercial customers in Harrison County and the northern portion of Bourbon County, Kentucky.

#### TEST PERIOD

Harrison County proposed, and the Commission has accepted, the 12-month period ended June 30, 1983, as the test period for determining the reasonableness of the proposed rates. In utilizing the historic test period, the Commission has given full consideration to known and measurable changes found reasonable.

## REVENUES AND EXPENSES

Harrison County proposed several adjustments to its test-period revenues and expenses. The Commission is of the opinion that the proposed adjustments are generally proper and acceptable for rate-making purposes, with certain modifications.

### Purchased Water

In its application Harrison County proposed an adjustment to increase operating expenses by an amount of \$9,164 to reflect a 22 percent increase in the cost of water purchased from its supplier, the City of Cynthiana, Kentucky. The Commission, in its analysis of this expense item, has applied the rates currently being charged by the City of Cynthiana to Harrison County's test-period monthly water consumption (in gallons), resulting in a test-period adjusted purchased water expense in the amount of \$50,319. Therefore, Harrison County's test-period operating expenses have been increased by \$9,076 to reflect the total amount of the pro forma expense.

### Fuel or Power Purchased for Pumping

Harrison County proposed an adjustment to increase test-period operating expenses by an amount of \$599 to reflect the increased cost of electricity purchased from Kentucky Utilities Company ("KU") and Harrison County Rural Electric Cooperative Corporation ("Harrison County R.E.C.C"). Harrison County based this adjustment upon the application of the respective current rates to the total number of kilowatt-hours purchased from each supplier during the test period. The Commission, in its analysis of this expense, has applied the current rates being charged by KU

and Harrison County R.E.C.C. to Harrison County's monthly consumption data, resulting in a test-period electric expense in the total amount of \$10,276. Therefore, an adjustment has been made to increase test-period operating expenses by \$1,057 to reflect the pro forma expense amount.

Operation Supplies and Expenses

According to the test-period statement of water operation and maintenance expenses, Harrison County incurred Transmission and Distribution Expenses--Operation Supplies and Expenses in the total amount of \$17,524. A breakdown of the expenses in this account was submitted as documentation in support of this amount.<sup>2</sup> An examination of this breakdown revealed that the \$17,524 amount was comprised of purchases of materials in the total amount of \$27,211 net of credits to the account in the total amount of \$9,548. Harrison County indicated that these credits represented reimbursements by its water customers for materials obtained at cost from Harrison County.<sup>3</sup>

To determine the potential for the capitalization of certain items in the breakdown, the Commission, in its Order dated February 21, 1984, requested copies of the invoices in documentation of expenses in the total amount of \$19,773. With regard to these items, Harrison County stated that any components of construction of new plant or major improvements to existing facilities had been capitalized, whereas any amounts recorded as

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<sup>2</sup> Response, Item No. 8, Commission's Order dated January 17, 1984.

<sup>3</sup> Response, Item No. 1, Commission's Order dated February 21, 1984.

operation supplies and expenses represented materials and supplies utilized for the repair of existing facilities.<sup>4</sup>

Upon examination of these invoices, the Commission has concluded that the entire \$19,773 amount represents items that either should be capitalized to the appropriate plant account, or should be included in Harrison County's balance of materials and inventory. Therefore, this \$19,773 amount has been reduced by the \$9,548 amount associated with the reimbursements from Harrison County's customers to achieve an operation and supplies expense adjustment in the amount of \$10,225. This adjustment, when deducted from the \$17,524 test-period expense amount, results in an allowable operation and supplies expense of \$7,299.

From the information submitted in this case, an accurate determination could not be made regarding the amount of these invoices that should be capitalized to water utility plant in service. Therefore, no adjustment has been made to operating expenses to reflect any depreciation that would be associated with the capitalized invoice amounts. The Commission may reconsider a depreciation expense adjustment in this case based upon Harrison County's providing of an adequate determination of the total invoice amounts that require capitalization. In addition, the Commission concludes that upon an examination and analysis of these invoice items, Harrison County should record, in the utility plant in service accounts, the appropriate amount of the invoices that should be capitalized and should establish an inventory account for the corresponding amount of materials and supplies.

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<sup>4</sup> Ibid.

Moreover, the Commission is of the opinion that, for future financial reporting purposes, Harrison County should capitalize all items of water utility plant to the appropriate plant in service accounts and should record all items of inventory in Account No. 150--Materials and Supplies, thereby complying with the reporting requirements established by the Uniform System of Accounts for Class A and B Water Utilities.

#### Outside Services Employed

Harrison County proposed an adjustment to increase operating expenses in the amount of \$1,360 to reflect the amount of additional fees to be paid to its truck-loading station operators. Harrison County related that these operators provide the space for the truck-loading facilities, maintain security, perform simple maintenance, and are available for water sales 24 hours per day. However, Harrison County also indicated that the number of hours devoted to these duties varies considerably among the five operators, with each averaging approximately 5 hours per week in association with the truck-loading sales.<sup>5</sup>

Harrison County's current method of compensating these operators for the services provided involves the payment of a fee in the amount of \$.50 per 1,000 gallons of water sold. The operators, who also collect the truck-loading sales revenue of \$3.50 per 1,000 gallons, remit these collections to Harrison County net of the \$.50 per 1,000 gallons fee.<sup>6</sup> As a result of

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<sup>5</sup> Response, Item No. 2d, Commission's Order dated February 21, 1984.

<sup>6</sup> Response, Item No. 2c, Commission's Order dated February 21, 1984.

this arrangement, Harrison County only reports as revenue the amount of sales remitted by the operators. In addition, Harrison County does not expense the fees paid to the operators for services provided at the truck-loading stations.<sup>7</sup> During the test period this expense was an amount of \$4,645 based on the number of gallons sold per Harrison County's billing analysis.

The Commission is of the opinion that Harrison County's failure to report as revenue the amount of the truck-loading sales collections retained by the operators, as well as its failure to expense an identical amount for the operator's fees is inconsistent with the principles of full disclosure. Therefore, the Commission finds that, for proper statement of its revenues and expenses, Harrison County should report as revenue the full amount of its truck-loading sales collections and should expense the total amount of fees paid to the operators in Account No. 676--Maintenance of Meters.

Harrison County has proposed to increase the fee paid to each truck-loading station operator to \$.65 per 1,000 gallons of water sold, thus reflecting the \$1,360 increase in test-period operating expenses. The Commission is of the opinion that the determination of this expense on the basis of the number of gallons of water sold is not reflective of the cost or value of the services provided by the operators. In addition, the Commission has concluded that, based upon the information submitted in this

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<sup>7</sup> Response, Item No. 5, Commission's Order dated February 21, 1984.

case, the increase in the proposed operators' fees is not justified by an increase in the cost of the services provided and should not be allowed for rate-making purposes. Therefore, the Commission has increased test-period operating expenses in the amount of \$4,645 to reflect the amount of operators' fees which was not reported as an expense on Harrison County's test-period income statement.

#### Payroll Taxes

Harrison County proposed an adjustment to increase operating expenses in the amount of \$40 to reflect the additional amount of payroll taxes that would be incurred as a result of an increase in employee salaries in the amount of \$2,234. Based upon the test-period actual tax expenses in the amount of \$3,623 as reflected in Harrison County's payroll tax analysis,<sup>8</sup> the Commission has calculated the increase in payroll taxes associated with the additional salaries to be \$195. Therefore, Harrison County's test-period operating expenses have been increased by this amount to reflect a pro forma payroll tax expense in the amount of \$3,818.

#### Depreciation Expense

Harrison County proposed an adjustment to decrease test-period operating expenses in the amount of \$68,877 to reflect the amount of depreciation expense associated with contributions in aid of construction. Harrison County determined this adjustment by calculating the proportion of contributed property to total

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<sup>8</sup> Response, Item No. 6, Commission's Order dated December 2, 1983.



utility property, and subsequently applying that percentage to the amount of test-period depreciation expense.

The Commission has computed Harrison County's pro forma depreciation expense on the basis of a composite depreciation rate applied to the original cost of water utility plant in service net of contributions in aid of construction. This calculation resulted in a test-period allowable depreciation expense in the amount of \$63,773.<sup>9</sup> Therefore, an adjustment to decrease Harrison County's test-period operating expenses by \$69,668 has been made to reflect the allowable amount.

Interest Expense

Harrison County proposed an adjustment to increase test-period operating expenses in the amount of \$42,048 to reflect a 1.2X coverage requirement associated with the principal and interest payments on its four notes payable with the Farmer's Home Administration ("FmHA"). As debt service coverage is the major factor considered in determining the revenue requirements of Harrison County, the Commission is of the opinion that the principal requirements on the four FmHA notes<sup>10</sup> should not be allowed as a pro forma adjustment to test-period operating

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<sup>9</sup>	Total Utility Plant in Service	\$3,967,637
	Less: Contributions in Aid of Construction	<u>2,047,941</u>
	Net Utility Plant	\$1,919,696
	Composite Depreciation Rate	<u>3.3228</u>
	Allowable Depreciation Expense	\$ 63,773
	Test-Period Actual Depreciation Expense	133,441
	Adjustment to Depreciation	<u>\$ &lt;69,668&gt;</u>

<sup>10</sup> Response, Item No. 2b, Commission's Order dated December 2, 1983.

expenses. Therefore, based upon the schedules of the amortization of the principal and interest payments on the four FmHA notes, the Commission has decreased test-period interest expense by an amount of \$1,078 to reflect the interest associated with the outstanding principal balances at the end of the test period. This adjustment results in a test-period pro forma interest expense in the amount of \$91,926.

✓ Phase IV Adjustments

Harrison County proposed an adjustment to increase its test-period operating expenses in the total amount of \$32,110<sup>11</sup> to reflect an estimate of the expenses associated with an approximate 96 additional customers expected to be connected to the system as a result of its Phase IV extensions of water lines. According to the application, these extensions would be financed by FmHA funds in the total amount of \$599,600. However, Harrison County did not amend its rate adjustment application to include either an application for a certificate of public convenience and necessity or a request for approval of the associated financing of the extensions, although it was so advised by the Commission.<sup>12</sup>

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11	Source of Supply Expense	\$ 3,357
	Pumping Expenses	2,012
	Transmission and Distribution Expenses	5,218
	Customer Accounts Expenses	8,007
	Administrative and General Expenses	13,516
	Total Phase IV Adjustments	<u>\$32,110</u>

12 Commission letter dated November 1, 1983.

Harrison County stated that the proposed adjustments were derived from the operating budget prepared by FmHA in association with the financing of the Phase IV extensions of water lines.<sup>13</sup> However, no supporting information was submitted regarding the basis upon which these estimated operating expenses were determined. Therefore, the Commission is of the opinion that the proposed adjustments relative to the Phase IV extensions are not known and measurable, and should not, for the purposes of determining rates in this case, be allowed as adjustments to test-period operating expenses. Harrison County may submit these proposed expenses for the Commission's consideration in future proceedings in association with an application for a certificate of public convenience and necessity and approval of the project financing. However, such proposed expense adjustments should be adequately documented and justified with regard to the basis upon which they are determined.

After consideration of the aforementioned adjustments, the Commission finds Harrison County's test-period operations to be as follows:

	<u>Actual Test Period</u>	<u>Pro Forma Adjustments</u>	<u>Adjusted Test Period</u>
Operating Revenues	\$ 267,656	\$ 4,645	\$272,301
Operating Expenses	<u>282,556</u>	<u>&lt;62,186&gt;</u>	<u>220,370</u>
Net Operating Income	\$ <14,900>	\$ 66,831	\$ 51,931
Interest Income	21,519	-0-	21,519
Other Income	504	-0-	504
Interest Expense	<u>93,004</u>	<u>&lt;1,078&gt;</u>	<u>91,926</u>
Net Income	<u>\$ &lt;85,881&gt;</u>	<u>\$ 67,909</u>	<u>\$ &lt;17,972&gt;</u>

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<sup>13</sup> Response, Item No. 7, Commission's Order dated December 2, 1983.

### REVENUE REQUIREMENTS

The Commission, having concluded that Harrison County's adjusted test-period operating loss is unjust and unreasonable, is of the opinion that the proposed rates should be approved, as the revenues in the amount of \$352,392 generated thereby will improve Harrison County's financial position. However, the Commission is concerned that, although the rates requested by Harrison County and approved herein will improve Harrison County's financial position, such rates are inadequate to produce a 1.2X debt service coverage as well as to provide sufficient coverage of the allowable operating expenses. Harrison County's financial position may be further enhanced by future growth in the system; however, the Commission is of the opinion that Harrison County will be unable to maintain operations at these rates for an extended period of time.

### SUMMARY

The Commission, after considering the evidence of record and being advised, is of the opinion and finds that:

1. The rates proposed by Harrison County and contained in Appendix A are the fair, just and reasonable rates to be charged by Harrison County, as they will produce gross annual revenues in the amount of \$352,392.

2. Harrison County has understated its test-period operating revenues and expenses, as it has failed to report the total amount of revenues generated from water sales at its truck-loading stations, and has failed to expense the total amount of fees paid to the operators of these stations.

3. Harrison County has incorrectly reported as expenses on its test-period income statement, amounts that should be capitalized as utility plant in service and amounts that should be recorded in materials and inventory.

IT IS THEREFORE ORDERED that the rates proposed by Harrison County and contained in Appendix A be and they hereby are approved for service rendered by Harrison County on and after the date of this Order.

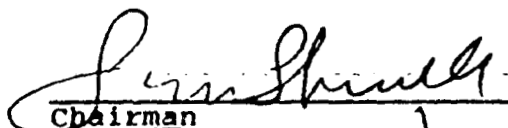
IT IS FURTHER ORDERED that Harrison County shall record the total amount of revenues generated from water sales at its truck-loading stations, and shall expense the total amount of fees paid to the operators of these stations in accordance with the Uniform System of Accounts for Class A and B Water Utilities.

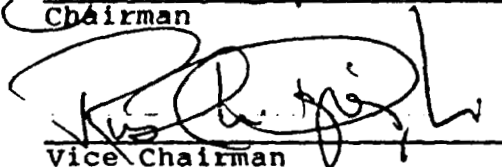
IT IS FURTHER ORDERED that Harrison County shall capitalize all items of water utility plant in the appropriate plant in service account, and shall record all items of inventory in Account No. 150--Materials and Supplies, in compliance with the Uniform System of Accounts for Class A and B Water Utilities.

IT IS FURTHER ORDERED that, within 30 days of the date of this Order, Harrison County shall file its revised tariff sheets setting forth the rates approved herein.

Done at Frankfort, Kentucky, this 25th day of April, 1984.

PUBLIC SERVICE COMMISSION

  
Chairman

  
Vice Chairman

  
Commissioner

ATTEST:

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Secretary

## APPENDIX A

### APPENDIX TO AN ORDER OF THE PUBLIC SERVICE COMMISSION IN CASE NO. 8911 DATED APRIL 25, 1984

The following rates are prescribed for customers in the area served by Harrison County Water Association, Inc. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the effective date of this Order.

#### RATES:        Monthly

##### 5/8-Inch x 3/4-Inch Meter

First	2,000 gallons	\$10.50 Minimum Bill
Next	1,000 gallons	3.70 per 1,000 gallons
Next	2,000 gallons	3.20 per 1,000 gallons
Next	45,000 gallons	2.55 per 1,000 gallons
Over	50,000 gallons	2.05 per 1,000 gallons

##### 3/4-Inch Meter

First	3,000 gallons	\$14.20 Minimum Bill
Next	2,000 gallons	3.20 per 1,000 gallons
Next	45,000 gallons	2.55 per 1,000 gallons
Over	50,000 gallons	2.05 per 1,000 gallons

##### 1-Inch Meter

First	5,000 gallons	\$20.60 Minimum Bill
Next	45,000 gallons	2.55 per 1,000 gallons
Over	50,000 gallons	2.05 per 1,000 gallons

1 1/2-Inch Meter

First 10,000 gallons  
Next 40,000 gallons  
Over 50,000 gallons

\$33.35 Minimum Bill  
2.55 per 1,000 gallons  
2.05 per 1,000 gallons

2-Inch Meter

First 15,000 gallons  
Next 35,000 gallons  
Over 50,000 gallons

\$46.10 Minimum Bill  
2.55 per 1,000 gallons  
2.05 per 1,000 gallons

Bulk Loading Station

\$ 4.50 per 1,000 gallons